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Leo Cherne: "1981 Economic Forecast"

January 6, 1981

LEO CHERNE: The distinguished guests on this dais will, I'm sure, forgive me if I single out three women. I'm delighted that our state banking commissioner, Mickey Siebert, is among us. Let me venture my first prediction. I'll be surprised if she's not head of the SEC in the new government.

[Applause]

CHERNE: There are no words which are satisfactory for me to express my debt and deepest personal pleasure that Happy Rockefeller is once again among us.

[Applause]

CHERNE: As to Liv Ullman, if she's willing to be my camp follower, I'll spend my remaining years building camps, breaking them, and moving on to new ones.

[Laughter and applause]

CHERNE: She is so singular a person, I can only hint of her remarkable qualities. And I cannot begin to describe her humanity. Her biography, changing, is not typical Hollywood ghost-written biography. The tears, the laughter, the regrets, and the growth in those pages are hers. More importantly, if you read them, they will change you.

Camp follower, indeed. As you've heard, UNICEF has appointed her to be their special ambassador to all those dismal places in the world where children languish, and too often die. And, as in that march to Cambodia we shared, she drops everything else to bring her touch, her empathy, and to see that, as

a result of her being there, that something will be done. And it invariably is.

How could I be more highly honored? More accurately, who could honor us all more than Liv did by joining us?

Now, this year's theme is "A Year of Promise in a Decade of Difficulty."

Liv, your radiant face, voice, and soul opens this year for us with majestic promise.

It's a long jump from Liv Ullman to Alan Greenspan. He said at a meeting we both addressed many months ago, "As long as we're dependent for something as basic as overseas oil, no short-term forecasts are worth making. The risk of surprise is the bane of economists and the dread of governments. Yet the risks involved in projections essential to planning nevertheless must be made."

In a devout Lutheran church in the North Woods of Minnesota on a Sunday morning, the soprano in the choir in the choir loft located in the balcony overlooking the congregation gave voice to one of the highest notes in her repertoire. And as she reached that note, she lost her balance, fell over the edge, but managed to break her fall by becoming entangled in the chandelier. Unfortunately, upside-down with her skirts over her head. The very strict pastor quickly admonished his flock, "If anyone looks up, I warn you, you will be struck blind instantly."

After a few minutes, Swen turned to his friend Ollie and said, "I think I'm going to risk one eye."

[Laughter]

CHERNE: Risk. And with risk, the need to adapt if the risk turns sour, which too often these days is the case.

A married woman was entertaining a male friend when they both suddenly heard a key in the front lock. The friend quickly asked, "Where's your back door?"

"I don't have one?"

"Where would you like one?"

[Laughter]

CHERNE: Just think for a moment, it was only four months ago that the world was enjoying a glut of oil, one million barrels a day more being produced than being bought. But one man's decision changed that. Iraq's Hussein made his bid

to become overlord of the Middle East by invading Iran, counting on a quick knockout blow. That one event, and the world has been changed in ways which cannot yet be foreseen.

I closed my remarks last January by saying I saw the signs of a turnaround coming that would affect America's destiny. These months ahead are when that turnaround, already with us, will begin to bear fruit. 1981 will be a year of promise. But this also continues to be the decade of danger in which the promising elements come barely in time, if not, in some respects, too late.

To call 1980 a year of massive change hardly does it justice. Many areas of public policy now are overcast with doubt. Most underlying assumptions are being agonizingly reappraised. A new and trying experience for a people so steeped in optimism.

The most painful of the ideas is the idea of U.S. pre-eminence everywhere. Now, however, the notion of the United States as second-best is spreading. Resentment has been stirred, a mandate given to a new President. And amid the bewilderment, frustration, and anger in the country, a new sense of realism is taking hold: the need to accept and adapt.

Nothing can bring back the peak of U.S. power after World War II. But there is the expectation -- I believe it to be reasonable -- that some things can be improved significantly.

The energy crisis, about which I've talked, I think, in every address I've made since 1974. The energy crisis shocked Americans out of their belief that they had the secret to the good life no one else could reach. The rest of the industrial world has caught up. Some have surpassed us. U.S. complacency is giving way to a search for new arrangements to restore some semblance of greatness, the campaign theme that elected Ronald Reagan.

Dependence on foreign resources has made another change. Americans simply are not self-sufficient anymore. And they know it. By 1985 export of goods and services -- just export of goods and services -- will amount to 18 percent of our total gross national product.

Now, clearly, much will depend on Reagan's ability to persuade, to give Americans a sense of direction they have missed for so long. To do that, he needs Congress; and turning around the Hill will be tough.

Let me look back, as I do traditionally, to my hits and misses. Since there were 35 specific expectations advanced a year ago, I obviously won't review each of them. But I learn most from my errors, and there were seven of those, including

that my expectation that the recession, which I correctly anticipated, was underway as I spoke to you. I was premature by a month. I thought it would be longer and deeper than it proved to be. I correctly anticipated the very meager growth in GNP year-end to year-end. I was, however, wrong in my expectation of average GNP for the year. I correctly anticipated that interest rates would go higher after we met, then drift lower to an 11-12 percent prime rate. But I did not anticipate, then, that the year would end with the prime rate over 20 percent.

I expected the Democrats to renominate Carter, but waffled sufficiently on the Republican choice -- naming Bush or Ford, but don't discount Reagan -- as to make that a worthless pass.

I was correct on the rate of unemployment, the rise in the cost of living, the increase in capital spending, the magnitude of the drop in housing and autos. I anticipated the steep drop in corporate profits and that wage increases would average nine percent. I expected the first substantial drop in the consumption of oil, and it has been dramatic. I also expected a real lift in the mining of coal, and this is one of the elements in our dramatic turnaround. I said we were not going to go anywhere on nuclear energy, and not one new plant was ordered in the last 12 months.

I envisioned 1980 as the year of intense competition involving the key to the future, the semiconductor, the microchip, and the related high-technology industries. If you went out and bought stocks blindly in virtually any of the companies making semiconductors, you've enjoyed a very good year.

I correctly anticipated the instability of Central America. Outside of the Middle East, this has now become the most important cockpit of serious concern to us. I warned that not just Iran, but the entire Islamic crescent would present us with enhanced danger. And indeed it has, almost daily. In fact, I was sufficiently concerned to point to Iraq, observing that its ambitious leftist leader, President Hussein, planned to replace Iran as policeman of the Persian Gulf.

I anticipated that the dollar would do well, and progress has been made against every major currency except the yen.

I expected a rediscovery or traditional, or conservative, values among the American people, and saw this development as the base for the turnaround toward economic health and a greater chance for national safety.

Enough of the past.

Before I spell out why this year will be a year of

promise, I ask that you not misunderstand that qualified optimism. We remain a nation not in control of our destiny. We cannot be, as long as the sources of our oil are so heavily overseas in what is clearly the least stable area of the world. We are enmeshed in a continuing struggle with serious inflation and unemployment. And I expect the rate of inflation to exceed 11 percent in 1981 for the year as a whole. In fact, I now think that eight to nine percent inflation is likely to be the average for the four years of the Reagan Administration.

The massive interest rates have aborted the recovery which was underway. We will emerge very slowly in a year of low growth without a return of recession, though the first quarter will feel a lot like one. Real growth in 1981 will range somewhere between zero and 1-1 1/2 percent. Unemployment will be up some, not much, eight percent. Housing starts will rise, but not hit 1 1/2 million. Detroit, with the economy as I have described it, they'll do about as well as they did this year, seven million domestically produced cars. Interest rates will retreat haltingly, until mid-spring, perhaps as late as the summer, and then slam up again by fall. Total consumer spending will go up about 10 percent, more than offset by inflation. And corporate profits will remain virtually flat. A 10 percent tax cut for three years will not be passed by the 1981 Congress, but a seven percent cut for this year will be. In addition to the cut in personal income taxes, the urgency of stimulating economic growth, corporate investment, and modernization leaves me to be virtually certain of further tax breaks on depreciation and investment credit; and a good chance, too, that savings interest will get a tax break and the rate of capital gains tax reduced further.

There's not enough left of this fiscal year for the Reagan team to squeeze the intended two percent out of the budget. I think they can get three percent out of fiscal year '82.

Reagan, very soon after taking office -- and the first indication will be in his inaugural address -- will lump all of the harsh steps he plans to take to make it clear that he really intends to break the inflationary fever. Confidence and expectation play as large a role in generating or limiting inflation as economic reality. He will use all of the leadership he can muster to sustain the confidence with which he starts, emphasizing that, as difficult as it will be and as long as it will take, he means to see this one through if we are to recapture the eminence we have lost.

A hallmark of the Reagan Administration will be predictability. And if there's one thing the business community wants even more than favorable policies, it is to know what they will be for a period of time.

Because I'm talking about Reagan at this point, let me

add that, unlike the last four Presidents, this Incoming President is a master public communicator who will use that instrument to establish leadership, where his predecessors concentrated on day-by-day running of the government.

The target for these next years is an increase in productivity. Without it, the international competitive thrust of our country will be inadequate, and significant inroads against the inflation impossible to obtain. And yet, for this year, there will be virtually no productivity improvement.

Government deregulation will be slow and, except for those environmental regulations which seriously impede industrial competitiveness, will be undramatic. Government regulations will be enforced less stringently in 1981. Compliance deadlines for OSHA, for the Federal Trade Commission, for EPA will be delayed, reporting rules simplified, investigative powers curtailed.

U.S. energy policy will see the largest changes, with the emphasis placed on total deregulation and intensified drilling of domestic oil. The windfall profits tax will not be dropped. The Energy Department will not be scrapped. However, its functions will be sharpened and compressed toward speeding oil and gas discovery and removing the bottlenecks which impede increasing use and export of coal. More of an effort will be made, by assuring the public of safety, to get nuclear energy back on track.

Our trade deficit will widen again this year. And the further increase in oil price that I anticipate still this year will wipe out the progress on our trade deficit we made in 1980. We face a deficit of \$35 billion-plus.

The poor economies afflicting our major trading competitors, coupled with the high price of oil that I expect, will intensify competition from foreign trade. We will nevertheless not go protectionist. We belatedly came to realize, especially in the case of Japan, we're competing with states rather than market economies. To the extent that our laws permit, we'll use national power to greater effect than previously.

National security will especially emphasize the absolute importance of vital steel and automotive industries. This, however, may not save Chrysler.

Foreign and domestic policies will be tougher and narrower. National interest, not world leadership, will be the keynote. Fuel priorities will be more bluntly asserted and followed through. Top priority will be a lot bigger muscle for the military. The first task will be the quick fixes for the existing weapons systems: stronger heads, more heads on Minuteman, shore up the aging B-52 bombers, higher pay to stop the technician

drain hemorrhaging in all the armed forces. At the same time, we will start rebuilding in every service toward a 600-ship Navy, a simpler MX, more Trident submarines, and a new B-1 bomber. The aim is to put visibly more naked power into U.S. diplomacy from here on. The cost? One to two trillion dollars over five years, Congress concurring.

This evidence of reviving power will be the main card counted on to convey to our friends and allies a new sense of perceived strength and a revived U.S. will to use it.

If the hostages are still not freed by January 20, President Reagan will start by reluctantly continuing minimal negotiations. But there is a sterner option in reserve. That's what his "barbarians" language was meant to convey. That's if the Iranians don't go totally berserk, try the captives or harm them in any other way. No President could sit still for that, this one particularly. And that includes military action by the U.S., with the concurrence of Jordan and Kuwait.

Soviet troops will not move into Poland until the Polish Army proves incapable or unwilling. The Kremlin cannot accept the heresy that the Polish authorities agreed to. If Soviet troops go into Poland, Reagan's response will be to declare detente dead, apply stiff economic sanctions, and declare the Helsinki agreement a dead letter. One option that can't be ruled out is a U.S. renunciation of the agreement which ended the Cuban Missile Crisis.

A significant and early change, in any event, thanks in very large measure to a distinguished guest on this head table who headed up the transition team, Frank Shakespeare, will be the strengthening of our radios which broadcast throughout Central Europe and throughout the entire Soviet Union. This will be a cornerstone in the revival of the U.S. political warfare capability. The U.S.S.R. will not have a clear one-way street in this direction any longer.

There will be a real change in U.S. involvement with the dangerous crisis centers right on our doorstep, especially in Central America and the Caribbean.

On SALT, Reagan will ask for negotiations, but SALT II is dead. Brezhnev can have a strategic arms treaty, the message will be, but he'll have to make genuine and verifiable cuts in his arsenal. Until and unless that happens, the U.S. arms buildup will go on.

In our confrontation with the Soviet Union, we'll encounter Soviet moves where U.S. interests are at stake. Reagan will act in the Persian Gulf, in Europe, and the nations which border on the Caribbean.

The President will stick to his support of Israel, though with less than his campaign vehemence. Israel's essential to the U.S. involvement in the Middle East. The Saudis and Jordanians won't like that, but two facts of life will keep them on the reservation. One is the eclipsing of the PLO as a Middle East force. The other is the recognition that there is no alternative for them to U.S. protection.

The U.S. will station significant forces in the Middle East. Indeed, a long-out (?) suggestions, if not prediction: 1981 may see Jordan shift toward accommodation, an essential toward durable peace.

NATO will continue to present problems for us. Reagan cannot reverse Western Europe's urge to accommodate the U.S.S.R. That's too firmly rooted in fear and economics. The strongest cement holding NATO together will be Soviet action. Whatever the outcome in Poland, it has already done more than anything we could do.

On intelligence, this will be the area of national security which will actually see the greatest strengthening accomplished in this one year, 1981. Covert action and counter-intelligence will get greater emphasis. But the main search for improvement will be in analyzing intelligence and making the estimates more accurate. The intelligence community will have a friend in the White House, and a very able one in its new Director, a friend of ours, William J. Casey.

Will all this result in a return to eminence? We will not again achieve the commanding role we had in the 1950s. More raw power, a readiness to play rough where it is needed, the down-playing of our tendency to moralize, these will raise respect for and fear of this country.

As I think I said once before, we will follow the maxim that when you make love to a gorilla, you don't quit when you're tired, you quit when he's tired.

An armistice or settlement in the Iraq-Iran war is not in the cards in the near future. When that war does come to an end, the odds are better than 50 percent that it will be followed by a convulsion in at least one of the two countries. From 3 1/2 to 4 million barrels a day of oil that came from that area will not be available quickly and will not be replaced. Don't be misled by today's depressed demand, unless you're ready to settle for today's minuscule worldwide growth.

Saudi Arabia has already warned that if we build up our oil reserves, they will turn down their faucets proportionately and raise the price. By January 1, 1982, oil prices are likely to be at least 30 percent higher than they were a month ago.

This is the year when several of the Third World nations will finally be unable to pay for the oil they require and also meet the carrying charges on the massive debts they owe Western banking institutions, our own banks included. And most countries, in and out of the Third World, will see the necessity to repress their economies and keep them at near-recession levels as the only way of limiting their use of oil. In fact, part of the reason for our own dramatic progress in reducing consumption was the recession we have been through.

However, we have also learned, finally, how to begin to be energy-efficient. There are no early answers to our continuing energy crisis. And as much as anything else, this makes the balance of this decade a decade of danger.

We will have to make large progress in our ability to compete with foreign products, both at home and overseas. Our productivity is only one measure of this. Quality, in many ways, is equally important.

Two embarrassing illustrations: Matsushita is the world's largest maker of electronic appliances. It took over the money-losing, poor-quality Motorola factory in Chicago; and with the American personnel in place, but Japanese management, within three years not only TV sets profitably, but those sets produced with American labor are now substantially higher in quality.

Even more astonishing is Sony's plant in San Diego: U.S. personnel, Japanese management. It not only holds Sony's worldwide record for quality, it actually went 200 days in a row without a serious quality defect.

It should give all of American management pause to realize that much of Japan's productivity and quality are owed to an American scientist, Dr. Deming, who since 1950 has been teaching Japanese management and labor to cooperate in working smarter, not harder. Japan's highest award to industry each year is the Deming Prize for Productivity.

If our new government has a challenge before it, let me say every bit as emphatically, so does American management. Because productivity can only be achieved by methods we once were master of and have badly neglected.

If it seems I'm overstating this, I'm now going to read a summary of Japan's official assumptions and policies in the 1980s. This is their guidebook:

One. Energy is Japan's number one problem, because of which the 1980s will represent a turning point in history.

Two. The U.S. is in a state of relative decline politically and economically.

Three. Economic security will be achieved through technological innovation. Government actions will be required because of the demands for large amounts of money.

Four. World growth will be less than four percent that prevailed in the 1970s. The GNP of industrialized countries will be three percent. Japan's will be more than five percent. Promotion of international trade is the key.

Five. Government research and development has represented one-third of total R&D. It must be increased to one-half.

Six, and final. The government must take the initiative in developing an ideal industrial structure which represents a consensus of academic life, business, labor, and the people. The 1980s, in Japan, will become an age of vitalized human potential.

There is the challenge.

Now, how, against this demanding background, can I conceivably describe this year as a year of promise? Here are the signs:

We have learned how deficient is our military power, and we will proceed this year on the lengthy effort to restore it.

We will proceed this year on the urgent need to stimulate personal savings needed for investment. Too much of our industrial plant is overage. Major changes in the tax law will be designed to change that, and especially to give a boost to high technology.

We have come to recognize there is no fundamental answer to inflation without a sharp improvement of productivity. And every candidate who ran for the presidency this year, including the candidate of the Libertarian Party, advocated measures to stimulate the growth of productivity. Five years ago it was a dirty word. No politician would dream of using it.

Only three years ago, we were importing nearly 10 million barrels of oil a day. In 1979, a shade more than a year ago, oil imports were still 8.8 million barrels a day. Last year our oil imports were down to seven million barrels a day. In a world oil study by the Congressional Budget Office, the estimate is that total U.S. consumption will go up very moderately during the entire 1980s, from 18.3 million barrels a day to 19.9. Whereas the rest of the world will rise from 51 mil-

11

1100 barrels a day to 66 in the same period of time. Yet their increased consumption will, of course, put enormous pressure on the price of oil. And we are likely to pay out one-half trillion dollars to OPEC during the next five years.

1980 was the first year in more than five that we have actually increased our oil reserves, even as we have increased our use of coal and natural gas. There's been a sudden burst of German, French, Belgium, even British, Canadian and Japanese, rushing to invest in American business, to take over U.S. business, establish plants in the U.S. For the next five years, this tendency will increase. They are lured by a cheap dollar, the world's largest market, labor costs which are now lower than theirs by a substantial margin -- Dresdner Bank in Germany estimates that our wage rates are now 25 percent lower than Germany's, Belgium, or France. And they come here because they see the United States as still the most capitalist economy on the face of the earth, where profit can be made and kept.

Now, these are all very substantial evidences of a fundamental turnaround, as was the election which echoed those manifestations. But the indispensable key, the key to that promise and the key to its being realized in a decade of difficulty will be leadership, all segments of leadership. Above all, the leadership which in this country can only be provided by the President.

I close with a quote from an important book written by two academics associated with NYU, London and Weeks, entitled Myths That Rule America: "Every society, Aristotle pointed out, needs a wondrous tissue of myth in which to envelop its traditions and ideals and to inspire its citizens to new horizons of achievement. A faith in freedom results in acts that affirm freedom's existence. A faith in the future leads to behavior that confirms the existence of the future." And it concludes, "Civilizations rise and fall on their ability to believe in themselves."

Whether we like it or not, as we look to the future, we carry the responsibility, not for our own welfare, but, without overstating it, for civilization's survival.

If this were a simpler time, I wouldn't close with so abstract an exhortation. Instead, I would use one of the many wise sayings of Warren G. Harding. One, particularly, has always remained in my mind, when he cautioned, "Do not drop the anchor until you're out of the woods."

Thank you.